



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

**Attachment to CR-103 Rulemaking Order
for
WAC 458-20-194 Doing business inside and outside the state**

Purpose:

WAC 458-20-194 (Rule 194) explains the taxability of persons doing business both within and outside Washington. Because the apportionment principles for persons engaging in activities subject to the service and other activities B&O tax (RCW 82.04.460(1)) are discussed in very general terms only, most of the Department's specific guidance on apportionment has been by Washington Tax Decision (WTD).

The Department is amending this rule to provide more detailed and specific guidance on cost apportionment for businesses engaged in activities taxable under RCW 82.04.290 (service and other activities B&O tax) and 82.04.2908 (boarding homes B&O tax). Historically, the Department has issued specific guidance concerning cost apportionment and separate accounting through published determinations (Washington Tax Decisions) as authorized by RCW 82.32.410. This has proved to be less than satisfactory for both the businesses and the Department, because the determinations address only the facts before the Department in a particular appeal.

The amended rule provides clearer guidance on apportionment principles that is consistent with statute (RCW 82.04.460(1)) and, to the extent possible, based on records that businesses generally retain for other purposes and fairly measures the Washington activity of businesses. The rule also provides clearer guidance on when a business should use separate accounting or the cost apportionment method for determining the business' Washington B&O tax liability. Examples have been added to clarify when a business is subject to Washington B&O tax because it has nexus with Washington and the standards the Department will use to determine if the business has nexus with another state.

The Department anticipates canceling Excise Tax Advisories (ETAs) 019.04.194, 269.04.194, 270.04.194, and 324.04.194/224 when an amended Rule 194 becomes effective.

Describe any changes other than editing from proposed to adopted version:

The term "rule" has been replaced with "section" throughout this rule.

(b)(v) of **Subsection 1 Introduction**—A cross-reference to WAC 458-20-236 (Baseball clubs and other sports organizations) has been added.

(x) of **Subsection (2)(b) Examples**—This subsection has been changed as follows (struck-out language removed and underlined language added):

~~These above~~ The examples in this subsection (2) apply equally to situations where the Washington activities and out-of-state activities are reversed. For example, in example (b)(ix) of this subsection, if the locations were reversed, the sales representative would have nexus with Washington, but not in Oregon.

Subsection (3) Multiple lines of business of proposed rule—This subsection of the proposed rule was removed with following subsections and cross-references modified accordingly.

The remaining changes refer to renumbered subsections.

(a) of **Subsection (3) Separate Accounting**—The term "activities" is substituted for "transactions" in the first sentence.

(b) of **Subsection (3) Separate Accounting**—The term “directly” was added so that the 3rd sentence reads “The result is inaccurate when services directly supporting these activities occur in different jurisdictions.” The following language has been added:

For example, if a taxpayer provides investment advice to clients in Washington, but performs all of its research and due diligence activities in another state, then separate accounting would not be accurate. However, if instead of research and due diligence, only the client billing activity is performed in another state, then separate accounting would be allowed.

(ii) of **Subsection (3)(c) Approved methods of separate accounting**—This subsection has been further divided into subsections (A), (B), and (C). The phrase “for another business” has been added to the language in subsection (3)(c)(ii)(C), which now reads:

If a business contracts to distribute advertisements for another business within the state of Washington, the gross amount received for this action should be reported as Washington income.

(E) of **Subsection (3)(c)(iii) Other reasonable and accurate methods—Notice to the department**—The term “imposing” has been moved and the phrase “of separate accounting” has been added so that the subsection now reads:

The taxpayer or the department, in requesting or imposing an alternative method of separate accounting, must demonstrate by clear and convincing evidence that the separate accounting methods in (c) of this subsection do not fairly represent the extent of the taxpayer’s business activity in Washington.

Subsection (4)(a) Apportionment ratio—The proposed language was moved to Subsection (4)(a)(ii), with the 2nd and 3rd sentences removed. These sentences had read:

A different ratio must be used for each line of business described in subsection (3) of this section.
Costs may not be included in more than one ratio.

Subsection (4)(a) Apportionment ratio—Language has been added in a new subsection (i), which reads:

Each cost must be computed according to the method of accounting (cash or accrual basis) used by the taxpayer for Washington state tax purposes for the taxable period. Persons should refer to

WAC 458-20-197 (When tax liability arises) and WAC 458-20-199 (Accounting methods) for further guidance on the requirements of each accounting method. Taxpayers must file returns using costs calculated based on the taxpayer's most recent fiscal year for which information is available, unless there is a significant change in business operations during the current period. A significant change in business operations includes commencement, expansion, or termination of business activities in or out of Washington, formation of a new business entity, merger, consolidation, creation of a subsidiary, or similar change. If there is a significant change in business operations, then the taxpayer must estimate its cost apportionment formula based on the best records available and then make the appropriate adjustments when the final data is available.

Subsection (4)(c) Noncost expenditures—The 4th sentence of this subsection has been changed as follows (struck-out language removed and underlined language added):

Costs of ~~another line of business under subsection (3) of this section~~ an activity taxable under another B&O tax classification are also excluded from ~~an individual~~ the apportionment ratio.

Subsection (4)(c) Noncost expenditures—Language has been added in a new subsection (iv), which reads:

Costs of doing a business activity subject to the B&O tax under a classification other than 82.04.290 or 82.04.2908. For example, if a taxpayer were subject to manufacturing, wholesaling and service and other activities B&O tax, the costs associated with a warehouse and a manufacturing plant (property and employee costs) are excluded from the cost apportionment formula. But if costs support both the service activity and either manufacturing or wholesaling (for example, costs associated with headquarters or joint operating centers), then those costs must be included the cost apportionment formula without segregating the service portion of the costs.

(A) of **Subsection (4)(e)(i) Definitions**—Additional language has been added. This subsection now reads (additional language underlined):

Depreciation as reported on the taxpayer's books and records according to GAAP, provided that if a taxpayer does not maintain its books and records in accordance with GAAP, it may use tax reporting depreciation. A taxpayer may not change its method of calculating depreciation costs without approval of the department;

(i)(B) of **Subsection (4)(e) Property costs**—The phrase “and warranty” has been added. The subsection now reads: “Maintenance and warranty costs for specific property;”.

Subsection (4)(e)(ii) Assignment of costs—The terms “warranty services” and “relative” have been added to the last sentence, which now reads:

Where a business contracts for the maintenance, warranty services, or insurance of multiple properties, the relative rental or depreciation expense may be used to assign these costs.

Subsection (4)(f)(ii) Allocation method—Language has been added to the first sentence. This sentence now reads (additional language underlined):

Employee costs include all compensation paid to employees and all employment based taxes and other fees, for example, amounts paid related to unemployment compensation, labor and industries insurance premiums, and the employer's share of social security and medicare taxes.

(i) of **Subsection (4)(h) Costs assigned by formula**—A reference to (a) of the subsection has been removed from the first sentence. The last two sentences of this subsection have been changed and combined as follows (struck-out language removed and underlined language added):

For example, ~~travel costs are not specifically assigned.~~ if a business has one thousand dollars in ~~travel~~ other unassigned costs and sales of ten thousand dollars in each of the four states in which it has nexus under Washington standards (including Washington), twenty-five percent (\$10,000/\$40,000), or two hundred fifty dollars of the ~~travel~~ other costs are assigned to Washington.

(iii) of **Subsection (4)(h) Costs assigned by formula**—Additional language has been added to the second to last sentence of this subsection as follows (additional language underlined):

For the purposes of this calculation only, the department will presume a taxpayer has nexus anywhere the taxpayer has employees or real property, or where the taxpayer reports business and occupation, franchise, value added, income or other business activity taxes in the state.

(iv) of **Subsection (4)(i) Alternative methods**--The term “imposing” has been moved in the first sentence as follows:

The taxpayer or the department, in ~~imposing or requesting~~ or imposing an alternate method